Exhibit 1

REPORTER'S RECORD

VOLUME 1 OF 1 VOLUME

COURT CAUSE NO. 2011-67305

FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER FOR FRANKLIN BANK, S.S.B. *Plaintiff,*	)IN THE DISTRICT COURT
VS.	)HARRIS COUNTY, TEXAS
MORGAN STANLEY & COMPANY, LLC, f/k/a MORGAN STANLEY & CO. INC. *Defendant.*	)151ST JUDICIAL DISTRICT

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MOTION IN LIMINE

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On the 1st day of June, 2015, the following proceedings came on to be heard in the above-entitled and numbered cause before the Honorable Mike Engelhart, Judge Presiding, held in Houston, Harris County, Texas.

Proceedings reported by computer-aided transcription/stenograph machine.

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MOTION IN LIMINE

CHRONOLOGICAL INDEX

(No exhibits in this volume)

P R O C E E D I N G S

06/01/2015 (Open court)

MR. GRAIS: Your Honor, with the Court's permission, I would like to address two of the motions together: The motion addressed to Franklin's specific knowledge and the motion addressed to the admissibility of newspaper articles and complaints against third parties. Because Morgan Stanley's position on these two motions rests on three fundamental misconceptions of law that are common to its opposition of both motions.

The first is Morgan Stanley's overly broad concept of materiality. Morgan Stanley argues that, although supposedly objective standard, there is a different standard of materiality for different types of Plaintiffs -- sophisticated plaintiffs, unsophisticated plaintiffs, plaintiffs in the real estate business and others.

For this proposition, Morgan Stanley cites only the report of its own expert Dr. Richards (sic). But, in fact, the standard of materiality is not only objective, it's also unitary. There is a single standard of materiality for all Plaintiffs, and it's not hard to imagine how chaotic it would be for Defendants to understand the scope of their duties, as

well as for the courts to administer securities litigation if the standard materiality varied by Plaintiff.

So whatever characteristics of Franklin Morgan Stanley thinks are material to the standard materiality can't be because the standard is both objective and unitary.

The second fallacy in Morgan Stanley's view of materiality is that it's somehow necessary to know everything about a total mix of information in order to decide whether an untrue or misleading statement changed the mix of information. Again, from a practical standpoint, if it were the case that courts had to ascertain the total mix of information, securities trials would never end. And there -- on the contrary, there should be some showing about why the untrue or misleading statements would have changed the mix of information in light of the particular information that Morgan Stanley is offering. To say that all the information that was known to Franklin or was available immediately about the mortgage market is not necessary to define whether statements about credit metrics of these loans changed that mix of information.

And the third problem with Morgan

Stanley's view of the materiality -- and I'll come back to this again in the knowledge defense, Your Honor -- is that it imports a surreptitious reliance defense into the statute, which the legislature has explicitly excluded.

Exception for the defenses of knowledge on the statute of limitations, both of which I'll come to you, nothing about the identity of the individual Plaintiff have anything to do with the claim under either the Texas Securities Act or Sections 11 and 12 of the 1933 Act.

By introducing this information about Franklin in particular, or sophisticated investors in general, there is a great risk that Morgan Stanley will mislead the jury into thinking that the sophistication of the buyer has anything to do with the merits of the Plaintiff's claim. Or even worse, into thinking that because of the sophistication of the buyer, it somehow had a duty to investigate the securities beyond reading Morgan Stanley's disclosure about them. And that is specifically not a law under both the Texas and Federal statutes.

THE COURT: Okay. Continue.

MR. GRAIS: Secondly, Your Honor, there is a common error in Morgan Stanley's position which

rests upon its misinterpretation of the Merck case.

THE COURT: Of the?

MR. GRAIS: Merck, M-e-r-c-k, in the Supreme Court. We argued the Merck case before, Your Honor, in the initial motions for summary judgment. And it's clear that under the discovery of the elements of the claim standard of Merck, that mere publication of a newspaper article or the filing of a complaint is irrelevant. Because unless it's admitted for the truth of the matter stated therein, which of course it can't be, the mere fact of publication has nothing to do with when the Plaintiff was able to discover all of the elements of its claim.

Morgan Stanley seems tacitly to admit that because it says that somehow or another Merck preserved the role for inquiry notice, the former standard that it relies on. And in particular in Page 7 of its brief in opposition to our motions, makes the statement that the trier of fact must identify the time at which there was storm warnings, as well as the time at which the Plaintiff actually discovered the elements of its claim.

But Merck says nothing like that, Your Honor. What Merck says is that under certain circumstances it may be useful to determine when

inquiry notice took place but only under limited circumstances. And apparently, what the Supreme Court had in mind was when a nondiligent Plaintiff argues that it couldn't have begun to investigate sooner.

Publications and other material not accepted -- not offered for the truth of the matter stated therein may be relevant to when it could have begun such an investigation. But there is no remaining role for storm warnings or inquiry notice after Merck.

And the idea that all of the newspaper articles and complaints against third parties are somehow irrelevant irrespective of the truth of the matter stated therein can't survive Merck as properly interpreted. There simply is no continuing role for inquiry notice.

And lastly, Your Honor, the third pervading error, if you will, is Morgan Stanley's misconstruction of the knowledge defense. The Texas statute specifically provides that the defense is that the buyer was aware of such untruth or omission. That is, unaware -- or aware of the falsity of the specific untrue or misleading statements. That view was, of course, adopted also by Judge Cote in the FHFA case.

The purpose of this defense is what

might be called no harm, no foul. If the buyer already knew that the statement was false, then the law has no interest in protecting the buyer because it was already aware of the falsity of the statements.

But what Morgan Stanley tries to do by offering, particularly, knowledge of Franklin as its sophisticated investor, is began surreptitiously to introduce a due diligence defense or a requirement of due diligence or a requirement to show reasonable reliance.

The knowledge requirement, Your Honor, was never intended to do that. It was intended only to negate the untrue or misleading statements. Specifically not to argue that the Plaintiff or the buyer should have known or could have known or had investigated further would have known, because then the knowledge defense as Morgan Stanley construes it slips immediately into requirements on the Plaintiff that the legislature specifically didn't provide.

Thank you, Your Honor.

THE COURT: I'm sorry. Can you elaborate on the part about it was not -- you said it was not intended -- one moment.

(Pause)

THE COURT: You lost me on the part that

it was intended to negate the untrue or misleading statements. It wasn't intended to do the other. I'm missing the nuance there. Can you restate that?

MR. GRAIS: Of course, Your Honor. The knowledge defense is limited to knowledge of a specific -- the untruth or misleading nature of the specific statements that the --

THE COURT: Okay. In other words, the actionable statements themselves as opposed to greater knowledge of the market and the -- things like that?

MR. GRAIS: Exactly, Your Honor.

THE COURT: Okay. All right. So that is the two motions in limine, the knowledge and the newspaper articles, et cetera.

MR. GRAIS: Just a brief word about Dr. James in hindsight. Dr. James was designated as a witness on negative causation for which his hindsight studies may be pertinent. But the law is clear that materiality is determined at the time of the investment. In this case, well before Dr. James's study and that nothing that happens after the investment is made is pertinent to whether or not the untrue or misleading statements were material when they were made.

What Morgan Stanley says is that in

stock-drop cases it's sometimes done to analyze what the market did when the true information was disclosed and therefore the untrue or misleading statement corrected. But as we express in our brief, Your Honor, that is not this case.

First of all, the truth has not been disclosed. Secondly, there is not the same liquid and efficient market that there is in stocks. As the Court is aware, the stock exchanges trade tens of millions of shares in most stocks daily. Mortgage-backed securities are traded over-the-counter; episodically prices are not systematically reported. And so the sort of event study that may be customary in stock-drop cases in efficient markets just has nothing at all to do with the determination of materiality in this completely different kind of security.

Materiality as Morgan Stanley and other Defendants argue in many other contexts is not determined by hindsight. It has to be determined as of the time when the investor had to evaluate the statement.

THE COURT: How would it work in a stock-drop case, what would be an example or circumstance where the subsequent -- when the

information -- the true information was disclosed and then the true or misleading statement corrected, what kind of circumstance would that be?

MR. GRAIS: If the misleading statement were corrected two weeks later and the stock went down, the materiality of the statement is evidenced by the fact that when the truth became known, the price of the stock reacted.

On the other hand, when the truth became known, investors didn't think it was important enough to bid the price of the stock down, then the inference is that it wasn't material. But again, that makes sense only in a highly liquid, highly efficient market. And it makes sense only when the disclosure comes a very short time after the allegedly untrue or misleading statement.

Here, years have gone by. And to look back as Dr. James did is something quite different from testing the reaction of the public markets days or weeks between an untrue or misleading statement and a corrected disclosure.

THE COURT: But he is looking in hindsight? Or is he actually writing a report that talks about what the -- putting himself back in time and looking forward?

MR. GRAIS: No, not at all, Your Honor. He's taking the performance of loans and tracing them through the years after these securitizations closed to see how they performed, which is obviously nothing that could be envisioned at the time of the purchase and sale of the securities. It's strictly by hindsight, Your Honor.

It's as if the Plaintiff were to say these loans went into default some months or years after the closing of the securitization and then asking the jury to infer from that that the statements about them were untrue or misleading. The purpose of the statute is to provide sort of a snapshot in time, if you will, Your Honor. Materiality is determined as of the time that snapshot is taken. And subsequent events, with the exception of the corrected disclosure in the efficient market, really have no bearing on what an investor knew at the time it had to make its investment decision.

THE COURT: Okay. Response.

MS. SESHENS: Is this on?

THE COURT: No.

MS. SESHENS: Your Honor, do you have a preference as to which I address first?

THE COURT: Perhaps go in the same

order.

MS. SESHENS: Sure. So turning back to the FDIC's motions concerning evidence of knowledge and the articles and the complaints, I'll address that first. And then turn to the motion concerning Dr. James and his materiality opinion.

I think contrary to the FDIC's position, Morgan Stanley is not taking an overly broad view of materiality. In fact, we recognize and it is in our papers and I think the parties agree that the standard for materiality is an objective one.

A material or omitted fact -- a misstatement or omitted fact, rather, is material if there is a substantial likelihood that the disclosure of the misstated or omitted information would have been viewed by the reasonable investor as having significantly altered the total mix of information made available. That is the standard, and I believe the parties all agree.

What comprises that total mix of information is in part where the parties disagree. And we've cited several cases in our brief, including the Kapps case, a Fifth Circuit Section 11 decision that the FDIC does not address in its reply, where the Court looked to publicly available information as part

of the total mix to render a disclosure immaterial as a matter of law. And it is that kind of publicly available information that Morgan Stanley contends is relevant to the materiality determination.

Similarly we've cited cases that talk about information known to the Plaintiff as being relevant to the total mix. The standard for materiality does seek to look at materiality from the perspective of the reasonable hypothetical investor, but that reasonable hypothetical investor has to be similar to or standing in the Plaintiff's shoes.

So, for example, you can't have a reasonable investor in an RMBS case who is completely unfamiliar with the mortgage markets or who doesn't understand RMBS. That was not the market for residential mortgage-backed securities. These were not, generally speaking, retail investors. There's a profile that comprises the reasonable hypothetical RMBS investor, and it is Morgan Stanley's contention that that investor is just like Franklin Bank.

And, in fact, Morgan Stanley's materiality expert Mr. Richard has offered his opinions, as has the FDIC's materiality expert, about what was important to residential mortgage-backed securities investors. And they talk about different

characteristics of the securities, different information that is available to them.

And Mr. Richard opines that Franklin Bank is just like the reasonable hypothetical mortgage-backed securities investor. The FDIC has not sought to exclude that opinion. And evidence about what Franklin Bank knew and the total mix of information is relevant to that.

Similarly, the FDIC doesn't cite any decisions to the contrary. They noted in their brief and Mr. Grais mentioned the FHFA case. The materiality decisions there were actually quite different. And there, there were opinions and information about materiality that went to the idiosyncratic nature of the Plaintiff in that case. The Plaintiffs, I should say, which were Fannie Mae and Freddie Mac, referred to as the GSEs generally; and they had an idiosyncratic whole loan business.

Whereas here, the opinions and the evidence show that Franklin Bank had a very typical whole loan business. And, in fact, Franklin Bank originated, sold and purchased the exact same type of loan that backs these securities that are at issue.

And so we contend, Your Honor, that under the standard of materiality as the parties agree

to it, information that is publicly available that is part of the total mix that is known to Franklin Bank compromises the total mix of information that's relevant to the materiality determination as seen from the perspective of a reasonable RMBS investor standing in the shoes of Franklin Bank. It is also --

THE COURT: So you're arguing their knowledge -- so you're going -- so help me state this correctly. Where FDIC is saying that the materiality is only related to the representations related to the actionable investment decision, you're saying that materiality goes beyond that to the, which is what they're concerned about in a roundabout way, talking about the more broadly Franklin Bank's knowledge of the industry or the market itself.

MS. SESHENS: We do think that's relevant, Your Honor, to demonstrate what a reasonable investor in Franklin Bank's shoes would have known and understood. We do agree with the FDIC that materiality is an objective standard and that it is assessed from the position of a reasonable RMBS investor.

We do think that information in the public domain compromises the total mix of information available to reasonable RMBS investors, and that

certain characteristics of Franklin Bank are reflective of and similar to the characteristics of a reasonable RMBS investor in part as opined upon by our materiality expert.

THE COURT: That's nice, but what you're really trying to do is use that opening to drive a truck through to show all the things that they're concerned about you showing.

MS. SESHENS: Well, respectfully, Your Honor, we're not intending to do that. I take a bit of umbrage with the notion that there's going to be some reliance defense here when there will be a jury charge that has nothing to do with reliance and there's not going to be discussion of reliance and it's not an element of a claim and it's not an element of a defense. So it's --

THE COURT: Please slow down.

MS. SESHENS: I apologize, Your Honor.

THE COURT: It's okay.

MS. SESHENS: So it's unclear to us how the jury is somehow going to think that reliance is at issue here. We do think that the evidence that is at issue in these two motions is relevant to various components of the case, but materiality is clearly one of them. We do think it is appropriate under the law

to consider that information; but there are other avenues, obvious ly, that we think it's relevant to as well.

THE COURT: Like what?

MS. SESHENS: So as we've put forth, Your Honor, evidence of what Franklin Bank knew and evidence of what Franklin Bank should have known based on, for example, the articles and the complaints that the FDIC challenges are relevant both to Morgan Stanley's knowledge defense, as well as to Morgan Stanley's burden to rebut the FDIC's showing of lack of knowledge under Section 12.

THE COURT: I'm sorry. That was a triple negative. Can you say that --

MS. SESHENS: Yes, of course. So under Section 11, Morgan Stanley has a knowledge defense where if it can show that Franklin Bank knew of the alleged misstatements and omissions , there can be no liability .

THE COURT: Right.

MS. SESHENS: Under Section 12, it is the Plaintiff's burden to show that the Plaintiff did not know of the alleged misstatements and omissions. And it is then Morgan Stanley 's opportunity to rebut that showing if the Plaintiff is able to make it.

That's just a difference in the burdens under the two Federal statutes.

So we think that the knowledge evidence and the -- well, the knowledge evidence is obviously directly relevant, we contend, to the knowledge defense. The knowledge evidence, as well as the newspaper articles and complaints --

THE COURT: What is the nature of that knowledge -- what is the knowledge -- is it a knowledge of the falsity of those specific representations, no, or omissions?

MS. SESHENS: That is what the FDIC contends. We do not think that it's drawn that tightly. We do think that the general knowledge is relevant, that the knowledge of the misstatements and omissions can be shown through the evidence that we've put forward. It is more circumstantial, but we don't think it's drawn as tightly as the FDIC.

And we also, Your Honor, believe that that evidence is relevant to our statute of limitations defense. I can pause for a moment if Your Honor has further questions on knowledge.

THE COURT: Yeah, please pause for just a moment.

MS. SESHENS: Sure.

(Pause)

THE COURT: So can you give me -- I'll ask you first, Ms. Seshens, and then Mr. Grais. As a practical matter, what would your two -- I'm trying to grasp the practical differences between the two standards of knowledge that you're talking about as it relates to this motion in limine where you're saying -- where the Plaintiff is saying that the only knowledge that's important -- that's material is their knowledge about the specific representations that are actionable here, as opposed to where you're saying that it's more broad than that and a total mix of information that touches on at least in part the market.

I know I'm not phrasing that accurately or precisely. But when we talk about Franklin Bank's knowledge about the representations, it's easy to -- that's easy to say. But as a practical matter, what does that really look like on the ground in real time?

In other words, if you're telling me the sky is blue -- which there's laws about that. If you're telling me that the sky is blue and I have access to -- I'm not going to be able to do this properly.

I can't imagine that it is so

laser-focused to be able to say that the evidence that relates to their knowledge about these representations is in this tiny little cylinder and you can look down in it and it's straight as an arrow. There's going to be real-world knowledge that the actual human beings at Franklin Bank had at the time that these representations were made.

Or are you saying, Mr. Grais, that the only material knowledge is their knowledge of the characteristics of these specific investment vehicles that were being offered to them at that time? Or is it more broad than that? And if it is, how is that practically different than what Morgan Stanley's arguing?

MR. GRAIS: It's the former, Your Honor. It's specifically it's knowledge of the fact that Morgan Stanley misstated the characteristics of these investment vehicles, these particular investment vehicles. And the Texas statute makes that clear by saying that the knowledge defense applies if the buyer knew that such untrue or misleading statements, if you already knew this, such statements were untrue or misleading. So the focus of the statute is on the untruth of the specific statements that the Defendant made while selling the securities.

A related point, Your Honor, is that there is no concept of should have known in the knowledge defense. In the statute of limitations defense there is, of course, the standard of when the Plaintiff discovered or should in the exercise of diligence have discovered, there is no such concept in the knowledge defense. It is purely a question of actual knowledge.

To import a should-have-known requirement is then to import a requirement of due diligence investigation on the part of the investor, which both the legislature and Congress expressly omitted.

THE COURT: And you're saying that's under Texas law but in a Federal claims that are in this case? (Sic)

MR. GRAIS: The same is true, Your Honor. The knowledge requirement focuses on the untrue or misleading statements specifically. In neither case is there a component of should have known.

THE COURT: Okay. So let me ask my question one more time, then. I appreciate what you've said and that gives me better understanding of your view of the requirement. But what is -- again,

what does that look like, how does someone in the position of authority at Franklin Bank to make these decisions know about the truth or falsity of these representations?

MR. GRAIS: Well, our view is that it wasn't possible because Morgan Stanley didn't disclose information from which it could be told. And they didn't know. I suppose had Morgan Stanley taken a different course and made the loan files available for inspection, for example, and had a hypothetical investor inspected the loan files, that perhaps could have conveyed knowledge that Morgan Stanley made untrue and misleading statements about the loans. But that's not what happened here.

THE COURT: All right. Could you try to go back and respond to the question that I asked a moment ago?

MS. SESHENS: Yes, absolutely, Your Honor. If I don't address it, please let me know. I think what Your Honor is driving at is how will this play out at the trial, what kind of evidence are we talking about. I think -- I don't want to speak for the FDIC, but I understand their position.

It would have to be evidence that Franklin Bank knew that the specific loans in the

specific supporting loan groups were not as they were reported to be. I think our position has been Franklin Bank had knowledge about originators of these loans, knew about, for example, rampant owner-occupancy fraud and amongst themselves remarked that they couldn't believe that everybody out in the world was now learning what Franklin Bank had known for a while, which is that owner-occupancy fraud was prevalent and there are owner-occupancy allegations in this case.

And so we would contend that knowledge of widespread owner-occupancy fraud is knowledge related to the alleged misrepresentations here. So that's one particular example.

There are similar examples with appraisal fraud, as well. There is evidence of knowledge of appraisal fraud in the industry. And so that, from our perspective, is probative of Franklin Bank's knowledge of the alleged misstatements here concerning inflated appraisals. Those are just two examples. I'm happy to provide some others.

THE COURT: So would you address those examples, then. So what counsel is saying -- and I'm not telling you anything you don't know, but what counsel is saying is that there is some amount of

experience and knowledge of the universe of these RMBS securities -- or that's redundant -- RMB securities that an investor would probably -- let's say they had actual knowledge.

Let's just say for argument sake they had actual knowledge of these concerns in the industry. Would that be relevant to this knowledge defense, or not at all? It's only the narrow rightful shot of what was told and what was not told?

MR. GRAIS: Exactly, Your Honor. It's as though someone were told, as Ms. Seshens posits, there's a lot of occupancy fraud going on out there. And from that, Ms. Seshens would ask the Court and jury to infer that the Plaintiff knew that Morgan Stanley had made misstatements about the specific loans in its transaction on which vehicle one of its fellow underwriters was doing due diligence.

It's important to remember, Your Honor, of course, that underwriters vet these loans and make filings with the SEC about them. What does not suffice is that a diligent investor would have found reason to investigate or anything like that. The only relevant point is whether or not the investor knew that those specific statements were untrue.

THE COURT: And that's the Merck case?

Or is that a different -- what's the best case for that?

MR. GRAIS: Well, the best case, Your Honor, is -- one is Judge Cote's opinion in the FHFA case, which is cited in our brief. And the other is just the plain language of the Texas statute, which limits the knowledge defense to knowledge or the falsity of such untrue or misleading statement, the specific one.

THE COURT: All right. I'll give you the last word, real briefly.

MS. SESHENS: Sure, Your Honor, if I may. Two quick points. I think one is Mr. Grais has been injecting this should-have-known standard as we've been talking about the knowledge defense. That relates to the statute of limitations defense.

THE COURT: I wasn't confused about that.

MS. SESHENS: Okay. So we're talking knowledge, we agree and understand we're talking about actual knowledge. The statute of limitations defense is different. I just want to touch upon that briefly.

The FDIC has repeatedly contended that inquiry notice, storm warnings, information about Franklin Bank, quote , unquote, should have known is

entirely irrelevant under Merck. And we have trouble understanding how that position is tenable given that Merck itself, for example, looked at pleadings in the public domain to determine the timeliness of the claims. That's in the Supreme Court case itself. Pension Trust, a Third Circuit decision we cite in our papers, in fact, applied Merck but applied inquiry notice within its analysis.

And, in fact, Judge Cote, who Mr. Grais just cited for the Nomura -- the FHFA/Nomura decision, also relied upon the inquiry notice standard in her Merck analysis. And so to contend that inquiry notice or what Franklin Bank should have known is irrelevant, even if Merck were to apply. And it is obviously our position that it does not. It finds no support, from our perspective, in the law; and we think that it is just wrong.

As a result, the motion that is directed to the complaints and the newspaper articles we think should be denied both because those are relevant, as we've discussed, but because they also are not hearsay because they're not being offered for the truth of the matter asserted therein.

THE COURT: They're not being offered for the truth of the matter asserted therein; they

were being offered to show when they should have been on inquiry notice?

MS. SESHENS: To show the fact that they were -- exactly, their existence in the market and to show when they should have been on inquiry notice.

THE COURT: Of course the fact -- what would have tipped them off would be the truth of the matter asserted, no?

MS. SESHENS: Well, not necessarily. You could have an article that relayed lots of information that caused you to question your investment, but it's not necessarily the case that the information had to be accurate. It could have just caused you to question it.

Our position is that the information that is in the public domain is sufficient to put an investor, Franklin Bank in this case, on notice. And the cases are legion that say that you can rely on complaints and articles in order to do that.

THE COURT: It sounds like what you've been talking about in this last little bit, maybe I missed it, is just the statute of limitations issue.

MS. SESHENS: That's correct. The articles and complaints we think relate both to materiality as part of the total mix of information as

we talked about and also the statute of limitations defense.

And I'm also happy to address Dr. James, Your Honor, whenever you would like me to do so.

COURT'S RULING

THE COURT: Before we get to the expert, I'm going to rule that -- I'm going to grant the motion in limine as to materiality and deny it as to statute of limitations. And so we may need to create some sort of instruction for the jury as to the purpose for which they may consider that information.

MR. GRAIS: Thank you, Your Honor.

THE COURT: All right. And the expert, Ms. Seshens?

MS. SESHENS: Certainly, Your Honor. The FDIC, as they've stated, challenges Dr. James's opinion as being an improper hindsight analysis of what was important to an investor, a hypothetical reasonable investor at the time of investment. We don't dispute that materiality is assessed as of the time of investment. But just because that is the case, it does not proscribe any number of different analyses to demonstrate that.

In many ways the materiality experts here are all looking backward in time, but there's no

one way to show materiality. We've shown through the cases we've cited that it is commonplace in the securities cases to look at information after the fact to assess materiality. The standard that applies in those cases is no different than what applies here. It's the same materiality standard. And the rationale for why courts in, for example, Section 10(b) cases look at materiality by focusing on stock price movement is because the theory is information that is important to investors moves stock prices.

Dr. James has applied the same theory here in an empirical way, which is information that is important to reasonable RMBS investors in past performance. He's just showing it -- he's an economist -- from an empirical perspective.

Mr. Richard and Ms. Rutledge, the two materiality experts in this case, are offering their materiality opinions based upon their experience in the market.

Dr. James is simply showing from an empirical perspective how these factors would have been or would not have been important to a reasonable hypothetical investor.

Ms. Rutledge, for example, could have conducted the same study. And had her study shown

that these characteristics that are allegedly misstated impacted loan performance, the FDIC could have relied on that analysis to show materiality. I imagine if that study would have borne that out, we wouldn't have had this motion here today.

Now, the cases actually support various ways to prove materiality. Event studies are only one of them. For example, a company can restate its financial information. And that can render -- and restatements generally arise out of material errors in the financial statements, let's say. But you can't determine if a prior misstatement was material based upon a restatement unless and until you have the restatement. And so you have to consider what has happened after the fact.

The Burlington case that the FDIC cites very prominently in its briefing talks about an event study, and it relies upon that to analyze a stock price drop. But then there's a section of the opinion that looks at an alleged omission -- allegedly omitted disclosure about discounts for supplies of coats. It's Burlington Coat Factory, I believe was the Plaintiff. And that the supplier wasn't giving as large a discount to Burlington for two particular months; and therefore, Burlington's costs were higher

and its numbers were not accurately reported.

The Court deemed that immaterial by looking at the full-year cost of goods and saying within that context those two months are not material because the cost of goods didn't rise overall. So the Court necessarily considered additional information after the alleged misstatement to determine the materiality. It is just another way of looking at it. Particularly when the analysis is from the perspective of a reasonable hypothetical investor. What would have been important to the investor. You can show it the way Ms. Rutledge tries to do it by talking about her experience.

But you also can show it empirically by looking at other factors and doing an economic analysis and that's what Dr. James has done. We think there's tons of support for it in the case law. The FDIC has not challenged the underlying analyses; and we therefore think it's appropriate in this case.

THE COURT: And so what does it mean -- what does that mean in terms of how the study was performed, to look at something from hindsight versus, as you say empirically -- in other words, can you -- what's the word I'm looking for? Help me understand the relationship between those two concepts, the idea

of hindsight and then empirically. What are you really saying?

MS. SESHENS: Sure. So what Dr. James did was he took a look at the performance of the loans that are in one group versus the performance of the loans in other groups to see how allegedly defective loans performed versus allegedly nondefective loans. I'm sort of simplifying for present purposes, but that's the gist of what he did. And the FDIC's contention is that that's impermissible because loan performance information wasn't available to an investor at the time of investment.

THE COURT: Okay. That's right, the word is "harmonized" is what I was trying to look for. So therefore?

MS. SESHENS: So they're contending that you can't do that, and we're saying it's entirely appropriate. People do it all the time in securities cases, as reflected in the stock-drop cases, as reflected in the Burlington case, as reflected in cases that look at restatements as evidence of materiality. That because it's a reasonable hypothetical investor, what would have been important. You can demonstrate that multiple ways. You can show it by, as the FDIC is trying to through

Ms. Rutledge, who has opinions about what was important in the investment process; but you can show empirically on the same theory that applies to the stock-drop cases where the same standard of materiality applies as it does across Section 10(b) and across Section 11 and across Section 12 .

So our position is that it is just one way of showing materiality and there's nothing in the materiality standard or in any of the case law that precludes an expert from doing so.

THE COURT: But do you agree that what Ms. Rutledge is doing is looking at it at the time , whereas the empirical analysis is in fact using hindsight?

MS. SESHENS: No, no, I don't, Your Honor. And this is why. I think Ms. Rutledge is necessarily looking back at the time from after the fact with all of the information she knows now and all of the experience she's had since then.

She does render her opinions, as does Mr. Richard , our materiality rebuttal expert, about what was important to reasonable RMBS investors. But I don't think that Dr. James is looking at it with hindsight to be sure he's using information that is available -- that was available after the time of

investment --

THE COURT: Only after the time of investment.

MS. SESHENS: That is correct. But he is doing that to demonstrate what would have been important to a reasonable investor at that time because what would have been important to a reasonable investor at that time was information that impacted loan performance. It's the same theory that underlies looking at stock price movements to demonstrate the materiality of previously disclosed information.

THE COURT: Response.

MR. GRAIS: May I briefly, Your Honor?

THE COURT: Yeah.

MR. GRAIS: The gist of what Dr. James did is to use the fact that the country had the greatest recession since the Great Depression. To obliterate the materiality of the misstatements that Morgan Stanley just made, may I just give Your Honor an example?

Many investors would say that if the LTVs of the mortgage loans had an average of 75 percent, that would be sufficient to avoid default on their bond in all circumstances of recession that the United States had seen in the last 50 years.

If it had been 85 percent, they would say that would not give us enough protection. So the difference between 75 and 85 percent when looked at without foreknowledge of the future is very important because in the context of the recessions that the United States have experienced up till then, that made a big difference in the safety of the bond. Well, what happened is that along came the greatest recession and it overwhelmed both of those protections. And so even an LTV of 75, while sufficient to protect the bond under normal circumstances, proved to be insufficient to protect it in these extreme circumstances.

All Dr. James is doing is saying it turned out that this was the greatest housing debacle ever and loans all performed badly because the differences in quality ceased to be important in the face of the economic disaster, but nobody knew that that was coming.

And looking forward, investors analyzed these loans and said, Given the circumstances that I predict, the difference between 75 and 85 is very important. The fact that even 75 couldn't withstand the great recession is pure hindsight and irrelevant besides because really what Dr. James should have done

is figured out how those loans would have performed under a variety of economic scenarios if he wanted to do a real post-facto analysis.

That's why whatever Ms. Seshens may say about event studies in stock-drop cases, this post-facto view that because the recession loans performed poorly irrespective of where their LTVs were is just a comment on the severity, the housing prices, it's not a comment on materiality of that information at the time the investor was looking forward.

MS. SESHENS: If I may, Your Honor? Which is just one last point. I think what Mr. Grais has just articulated is the FDIC's perhaps cross-examination or response to Dr. James but not a reason to render his opinion inadmissible.

THE COURT: How does looking at the stock -- or how is his analysis relevant to a question that the jury will be answering?

MS. SESHENS: The jury will be asked, Your Honor, to assess the materiality of the alleged misstatements and omissions, and his analysis would be relevant to that determination.

THE COURT: Well, okay. I understood that part. But I mean if we're looking at -- if I've already assessed the materiality from the -- if it

can't be a backwards-looking view -- I'm still struggling with the relevance.

MS. SESHENS: So some of this gets into more of the granularity of mister -- I keep calling him mister; he would be offended by that -- Dr. James's study, which in fact controlled for identified groups of loans based on the alleged defects that the FDIC's experts identified in the loans about departures from underwriting guidelines, inflated appraisals and the like. And so those are the very alleged misstatements at issue in this case.

So Dr. James separated the loans based upon those characteristics and then controlled for other characteristics that could otherwise impact performance. And so he tested the very materiality of the specific alleged misstatements at the very loan level in this case according to the FDIC's expert.

So it's directly relevant, these loans, these offering documents; and it's exactly in that spot. So it would be an analysis that the jury could look to as it considers materiality as a complement to Mr. Richard, our materiality expert, and as somebody who is either contrary to or rebuttal to Ms. Rutledge, who will be offering the FDIC's opinions, as we understand it.

THE COURT: And if you can, articulate the different conclusions between Ms. Rutledge and Dr. James?

MS. SESHENS: I think Ms. Rutledge, and obviously Mr. Grais can correct me if he thinks I've gotten this wrong, in a nutshell will testify to the various characteristics of residential mortgage-backed securities that she thinks were important to investors as part of their investment decisions and she'll focus on, perhaps not surprisingly, the alleged -- the characteristics that are at issue in this case. She will focus on some others but, you know, LTV ratios, owner-occupancy, conformity with underwriting guidelines; and she'll opine that those were important.

We obviously -- we actually don't think that goes far enough, but that's an issue for a different day. Whereas Dr. James --

And she'll provide no empirical evidence, she has performed no studies, she's undertaken no analysis. It is just her views based on her experience.

Dr. James, however, has undertaken an analysis. Because he's an economist, it is his view generally -- again, I hope I'm attributing to him

okay -- but that you can test these propositions, you can test empirically whether LTV ratios or the allegedly misstated LTV ratios were important to a hypothetical reasonable RMBS investor. And that's what he set out to do. He's simply --

THE COURT: Doesn't that sound more like causation than materiality?

MS. SESHENS: I don't think so, Your Honor. Because the concept is what is material, what is important will impact loan performance. And loan performance is what is most important to an RMBS investor because it impacts the investor's ability to obtain cash flows that it's otherwise owed under the security. So it goes directly to what is most important because it is what impacts the ability for the investor to get paid.

THE COURT: But they wouldn't -- but how do they base an investment decision on that if you are -- it would be impossible for them to have that information at the time they made the investment decision.

MS. SESHENS: Correct, as it relates to these specific populations of loans, yes.

THE COURT: And so is his analysis of these loans, as you say, empirical? Or is his

analysis more broadly the RMBS market?

MS. SESHENS: His analysis is of these loans, an empirical analysis of these loans.

THE COURT: So tell me, then, one more time. If it is impossible for them to have had this information, how is it material in their investment decision?

MS. SESHENS: Well, it shows that it's not material. It's a way of demonstrating a lack of materiality. He's not saying --

THE COURT: But doesn't that stand the concept of materiality on its head?

MS. SESHENS: I don't believe so, Your Honor. Because, again, while you have to look at materiality at the time of investment, you can show materiality through many different ways. You can look at it from all different perspectives.

THE COURT: If the stocks -- well, never mind. That's a different statement. Start again. What does it mean to say that you can look at materiality in lots of different ways? Materiality is what you base -- what are the variables that go into making your investment decision?

MS. SESHENS: Correct. The question here for materiality, as Morgan Stanley sees it, is

whether the alleged misstatements and omissions as identified by the FDIC would have been material to a reasonable investor. It's hypothetical.

THE COURT: And separately, as I had said a moment ago, is a causation. Or is there not -- I know we talked about negative causation, but I don't remember from the 20 or 30 hearings we've had whether causation is an element. Here it's not.

MS. SESHENS: Causation is not an element of the FDIC's affirmative case. It is an affirmative defense for Morgan Stanley.

THE COURT: That it didn't cause?

MS. SESHENS: Correct, that the alleged misstatements --

THE COURT: Would this --

MS. SESHENS: -- and omissions did not cause --

THE COURT: Carolyn, I'm so sorry.

MS. SESHENS: -- the loss.

THE COURT: Would Dr. James's analysis also be -- or would it be relevant or is part of what he's going to testify -- is he a negative or one of the negative causation experts?

MS. SESHENS: He is, Your Honor. That is correct.

THE COURT: Because it really sounds to me like you're talking about -- I don't mean conflating in a negative way like you did something wrong. But it seems like you're attemp ting to have the Court conflate the concepts of materiality and negative causation.

MS. SESHENS: I think from our perspective, Your Honor, we think that the analysis actually can support both. And it's not conflating them because they're two separate concepts and the empirical analysis, the underlying studies that Dr. James conducted, can give rise to different expert conclusion s.

THE COURT: All right. So one more time, then. Let's flip this around . Ms. Rutherford (sic)?

MS. SESHENS: Ms. Rutledge.

THE COURT: Ms. Rutledge, excuse me. Rutledge was the Giants' quarterback . Rutherford is where the Giants play.

(Laughing)

MS. SESHENS: I'm not going to tell you I'm an Eagles fan.

THE COURT: Boo. You're the one.

MS. SESHENS: I am the one.

THE COURT: The -- now I lost my train of thought .

Okay. So look at Ms. Rutledge , and her analysis is -- do you agree that her analysis is at the time and not looking backwards ?

MS. SESHENS: I would actually take issue with the notion that she has an analysis.

THE COURT: All right . Excuse me . Her --

MS. SESHENS: I think that her perspective is that she is trying to opine on what would have been important, what was important to RMBS investors when they made investment decisions .

THE COURT: Okay. So then it's fair to say, then, for better or worse , she's not looking at the performance over time. So she doesn't fall into that potential trap.

Are there other experts of theirs that have any sort of analysis? That is, looking at these loans over time? Do they have -- they have their own negative causation expert , I would imagine, to rebut your --

MS. SESHENS: They have a rebuttal causation expert, yes.

MR. GRAIS: Your Honor , our two most

important experts on our liability case are t hose who will testify about whether or not the loans complied with underwriting standards and whether or not the appraisals were done properly. In both cases we have specifically removed from the files they reviewed any document dated after the loan was paid precisely to avoid this problem of hindsight.

MS. SESHENS: I think -- Your Honor, to be fair, I think it's hard to say that the FDIC's experts don't do a hindsight analysis. They are going back in time and they are rereviewing what was done and reanalyzing it based upon , in some instan ces we contend , additional information and things that were not known at the time. And it's exactly what they are doing.

Now, that's not something that's before Your Honor today , but I think in fairness that is what is going on both with the appraisal and the reunderwriting expert .

THE COURT: A nd the case that stands for the proposition that it should not be a hindsight analysis , your best case is what ?

MR. GRAIS: Frankly, I'm not sure which are the ones we cited in the brief I would most recommend, Your Honor, but there are many,

many.

THE COURT: All right. Let me try the other bite. What should I look at to support your argument that this analysis of looking at the performance over time is something that could be considered, the Burlington case?

MS. SESHENS: I think the Burlington case supports that. The Gebhardt case that the FDIC actually has cited--

THE COURT: Did you say Geb?

MS. SESHENS: G eb. G-e, B as in boy, h-a-r-t (sic). Those are two cases that support, we think, our position.

And I apologize, Your Honor, there are a number we cited for the notion that you can look at after-the-fact information to assess materiality in the 10(b) context. I don't have those cites immediately, but I can provide them to you before the end of the hearing, if that would work.

THE COURT: Sure.

MS. SESHENS: Okay.

THE COURT: Okay. I'd like to look at those cases one more time.

MS. SESHENS: Sure.

THE COURT: Just to see if I can discern a bright-line rule.

MR. GRAIS: Your Honor?

THE COURT: I mean, I do think that information would naturally be relevant to negative causation. I'm not certain that it's relevant to materiality.

MR. GRAIS: May I just ask one question to clarify the Court's order on the other two motions?

Your Honor said you were denying the motions with respect to the statute of limitations. I assume that that's the one on newspapers and complaints against third parties.

THE COURT: Right. The other one doesn't seem to lend itself to that.

MR. GRAIS: And then you said you were granting the one as to materiality, which I assume is the knowledge part.

THE COURT: Yes.

MR. GRAIS: Thank you, Your Honor.

THE COURT: Yes. Okay. Now I guess -- so let me hold off on the Dr. James part. And I guess we'll turn to your omnibus motion. It's exactly 4:01. That's pretty good. So there's just

a handful that are -- have been agreed to or worked out?

MS. SESHENS: That is our understanding, Your Honor. And we've gleaned that from the FDIC's opposition papers, so I can't say with certainty that they won't stand up today and say that that's not the case. But I'm happy to identify the ones that we think -- there are two. I apologize. There are two they have said affirmatively they're not opposing. And then there's three others -- three and a half we've identified as ones they don't contest in their opposition. And so I'm happy to run through.

I don't know if Your Honor has our Appendix A to our motion, which is this chart that lists out every motion and sub motion. We can pass up a copy if it would be -- yeah, it's become my Bible on me, so I thought it might be helpful to Your Honor.

THE COURT: Dana's Bible?

MS. SESHENS: Yes.

THE COURT: Where did he go --

MS. SESHENS: Or Torah. Depends on. . .

THE COURT: Where did Dana Bible go?

You got nothing for me .

MR. YETTER: No, I'm sorry , I don't. That doesn't --

(Laughing)

MR. CALLAHAN: Your Honor, t hat would be the University of Texas . Dana --

THE COURT: Dana X. Bible, right ? Yes.

MS. SESHENS: Now you've completely lost me .

MR. CALLAHAN: Football coach.

THE COURT: Sorry . The University of Texas.

Okie doke. Well, let's just start at the beginning , then , and somebody jump up from the other side and tell me if you don't oppose it.

So Motion In Limine Number 1 , Full-Principal Method of Calculating Interest and Damages.

MS. SESHENS: Yes. So I'm happy to start there, Your Honor. This motion is directed at the FDIC's damages expert Ms. Rutledge and her opinion on what she terms the full -principal method.

Before I get into the substance , I

just wanted to identify a few key points. Obviously this motion assumes that Ms. Rutledge testifies at trial and she's not excluded for the reasons that were raised in our prior Daubert motion.

I did want to frame the issue for the Court by noting that based on Ms. Rutledge's opinions, we think that is at least a 25-million-dollar issue. And, in fact, likely more. That the difference between her amortizing principal and full-principal method is that material in the case.

We have moved on the application of this method to all of the claims asserted by the FDIC, including Section 11. The FDIC has taken its position -- taken the position in its opposition that this doesn't apply to Section 11. That is not correct.

They also have not opposed our Section 12 arguments at all. They've only argued about the TSA. And, therefore, we would deem those points conceded as to Section 11 and Section 12 and unopposed. I have a feeling they may say otherwise, but that is the sort of half motion I was referencing previously.

The question of what damages can be put before the jury is a question of law. There's no dispute between the parties on that. We think this is an issue that can be decided now , and there's no reason to wait until trial.

So with that , I will start . As Your Honor likely understand s from the briefing , this method -- the full-principal method impacts the way in which Ms. Rutledge calculates prejudgment interest as part of her damages calculat ions.

And as it applies to Section 12 and really the TSA , according to the FDIC, her opinion applies interest on the full consideration paid by the FDIC, really Franklin Bank , for the securities without accounting for princip al repayments that were received by Franklin Bank and the FDIC over time.

So what that means is in an RMBS situation , if you pay a hundred dollars for a security and then you receive princip al back, that balance , the consideration paid declines . You receive back the monies you paid out . And Ms. Rutledge is applying interest on the hundred dollars rather on the declining balance , which we contend is improper in this context.

THE COURT: Now, prejudgment interest is something that -- is this the kind of prejudgment interest that would be something the Court would determine post verdict , if appropriate, right, to factor into a judgment as opposed to something the jury would be deciding , no?

MS. SESHENS: I don't -- I think it's part of what the jury would decide because it's part of the statutory damages formula , at least for Section 12 and the TSA because it is -- the damages themselves include the interest component . So it is part of , for example , Ms. Rutledge's opinions and it is part of the rebuttal opinions that address these matters.

THE COURT: Anybody want to chime in on that point?

MR. YETTER: That's an interesting point, Your Honor . I'm going to argue this point on our behalf . And we have not given that enough thought , but that's a very interesting point because it's pure prejudgment statutory interest under Texas law 6 percent. And obviously that could streamline things a lot for trial.

But for the moment if you could hold that thought , we will give it more thought and we

will get back to you on that . We're prepared to argue the rest of the points , but that's a very interesting thought.

MS. SESHENS: And obviously , Your Honor, we'd be happy to consider that further. It's always been our understanding it would be part of what is presented to the jury. But if there's reason to think that that's otherwise, we obviously would give that some consideration as well.

THE COURT: I mean, if it's statutorily part of your damages versus I figure out what you r actual damages are and then calculate prejudgment interest, obviously -- I guess those would be two different creatures.

I don't know how the -- and I guess you would give the jury -- I'm trying to think how the jury would actually do le that out if it was part of your damages . I guess you would just give them the, This is how I arrived at this figure and it's more persuasive than the other fellow's version, and so you should award this X amount of prejudgment interest , period.

MS. SESHENS: I think there's not much dispute. The formulas , obviously , are the formulas . The dispute is really over how you

calculate prejudgment interest. I will say that this issue has come up in other cases and it has been decided, for example, as a matter of law in a summary judgment motion. It was applied by the Court in Nomura at trial, and it was part of the damages formula as it was considered by the Courts in those cases.

It is not a case where you have a damages finding, and then there's a separate statutory interest component. It is actually baked into the statute, at least for Section 12 in the TSA. There's a different component of this for Section 11, which I'll get to in a moment. But for Section 12 on the TSA, it is part of the statutory formula. And it's the same for both.

THE COURT: Okay.

MS. SESHENS: So our position, as I've just articulated, is that Ms. Rutledge cannot be permitted to opine to the jury on her full-principal method because it basically double rewards the FDIC by paying interest on principal that was already received.

The FDIC does not cite a single case to support its position. And by contrast, the only two courts in RMBS cases of which Morgan Stanley is

aware that have considered the issue have supported Morgan Stanley's position. That's the Schwab case that we've cited i n our papers in California and the Nomura case, the FHFA case that Mr. Grais and I both referenced earlier today.

In both of those instan ces, the Court held that the prejudgment interest had to be applied to a declining princip al balance and could not be on full principal . In Nomura, the Plaintiff didn't e ven advance a full-principal methodology , and the Court applied the -- effect ively, the amortizing princip al methodology , which is Ms. Rutledge's other set of opinions.

Federal courts that have interpreted Section 12 's damages provisions over time are in accord with those holdings. The Loftsgaarden case and the John s Hopkins cases that we 've cited all reflect that you get an offset in effect for consideration repaid when it is a declining balance security such as an RMBS . Or in those cases they were different types of securities.

But on the theory that Section 12 and the TSA are recessionary statutes, which are intended to put the investor back in the position he or she was in initially, that's the only way

that you can do it without providing the investor with a windfall.

Now, the FDIC contends that there is no unjustified windfall here. That it's appropriate to essentially double recover because the statutory purposes of the TSA are furthered by that. We respectfully disagree.

The statutory purposes that they've identified are not unique. And there is nothing that the FDIC has pointed out to show why or how those purposes aren't furthered by the amortizing principal method and by the ability to bring a private cause of action and by the ability to have a strict liability claim.

For those reasons, prejudgment interest is not intended to punish a Defendant. It is not intended to over compensate a Plaintiff. It is intended to restore the Plaintiff to the position he or she would have been in had the transaction not happened. And there's nothing that the FDIC identifies that is to the contrary insofar as amortizing principal should apply.

With Section 11, the application of the methodology is a bit different. There is no prejudgment interest there. The formula, in

essence, is the price paid minus the price received upon a disposition. And there the price paid is analogous to the consideration paid .

And Ms. Rutledge again has offered two opinions. She herself has recognized that there's a lack of clarity -- that is what she has said -- in how interest should be calculated . And she did the full-principal method where she applied the damages formula without accounting for principal repayments and she did an am ortizing method where she does account for princip al repayments.

And the reason that princip al repayments should be deduct ed from the price paid for Section 11 is exactly the same as the reason it should be deducted from the consideration paid for Section 12 . To hold otherwise would provide the FDIC with Section 11 damages that would include monies already repaid on the securities . Again, a double recovery.

Section 11 , like Section 12 in the TSA, are compensatory in nature . They are not punitive . And there 's nothing that the FDIC has identified that supports application of the full-principal method to Section 11 damages as

well.

THE COURT: Response?

MR. YETTER: Yes, Your Honor. Paul Yetter for the FDIC. We should have a short, little presentation, Your Honor, that will help us to go through, if the Court allows me?

THE COURT: Sure.

MR. YETTER: And it should be on your screen. We can probably just do it on the screen, Judge, if that works, because I think all the lawyers will have it on their screens.

THE COURT: Okay.

MR. YETTER: All right, Your Honor. So I've only been given permission to talk about one thing today, Judge, in the interest of safety for my client. So -- hold on.

Really where we're at on this issue, this issue of the damages, is that Morgan Stanley is essentially calling in to issue the Texas statute, the Securities Act.

THE COURT: I'm not -- I don't see -- am I supposed to be seeing something?

MR. YETTER: Yeah, you should be seeing something on your screen, Judge. It doesn't look like you are. Maybe we can -- there we go.

See if that works.

(Discussion off the record)

THE COURT: There we go .

MR. YETTER: There we go.

THE COURT: I'm sorry , one more time.

MR. YETTER: Sure. Judge, the complaints that Morgan Stanley has basically go to the -- to the actual language of the legislature in the Texas Securities Act. So the language of the statute is very clear. It adds interest. It says -- it's a very simple formula . It adds interest to the compensation paid for the security.

So you take the security the day you bought it , you figure out how much you paid for it, you add interest at the statutory rate until the day of trial -- or the day of the verdict. Then from that amount , you subtract certain things. You subtract all the income you've got on the security, which would be both your interest payments and your princip al repaid, and you subtract your sale proceeds.

So you start with the -- how much you paid plus interest, and you subtract income , which is interest plus -- that you got paid and principal repaid , and then sale proceeds . That's what the statute literally says.

They're saying, Nope, for this kind of security -- and that applies to all sorts of securities, Judge. Life insurance policies, all kinds of securities. What Morgan Stanley is saying for this kind of security for RMBs -- or RMBSs, that you have to have a different formula.

And so if you see the first bullet, it says what their -- what Morgan Stanley is basically saying is the statutory formula shouldn't be the actual compensation you paid, and then you add interest. It should be the actual compensation you paid less income you receive later, and then you add interest.

Now, that's not what the statute says; but that's what they're asking for, Your Honor. That's their amortizing principal basis. And they're saying, Oh, but if you don't do that, it's too harsh on people that violate the law with regard to residential mortgage-backed securities. And so what they're really proposing is a net compensation paid, then you add interest.

Now, here --

THE COURT: Didn't you start off by saying that you calculated -- I thought you started it off by saying that you calculated at net of --

MR. YETTER: No, you don't. Okay. So the statute says --

THE COURT: -- you made money on the security. You subtract -- you subtracted several things.

MR. YETTER: The whole p oint, Your Honor, is when do you add interest?

And what the statute says is you take the purchase price , then you add interest from the day of the purchase to the day of the verdict. Then you subtract.

THE COURT: Oh, okay. So your subtraction is after you've added the interest.

MR. YETTER: That's what the statute says. Now , what Morgan Stanley wants to say is --

THE COURT: G et the net first , and then calculate the interest.

MR. YETTER: Exactly . And that's wh y there's a difference.

THE COURT : Yes.

MR. YETTER: Because if you take out the income before you add the interest, then you're going to have a lesser amount .

THE COURT: That's like an attorney taking a fee on a gross recovery as opposed to the

net recovery.

MR. YETTER: Very much like that. So here what the statute says , for very good reasons , it says take the purchase price , then add the interest , and then deduct your income and your sales proceeds.

And there's three reasons . And I can, hopefully , Judge , quickly go through . So the first reason , number one . It's a very simple -- it's a very simple formula . And the Texas Supreme Court through the pattern jury charge says to trial judges , Use that formula when you charge the jury . And the formula is total purchase price plus interest, then you take off your income and your sales proceeds. And that's what it is right here .

The big dispute we have with Morgan Stanley is they want to take the income off twice because they want to take the purchase price, then subtract the income and add interest . And then they want to take the result and subtract income again the second time . And subtracting income twice is not what the statute says.

So, Your Honor, what the PJC tells trial courts to do is use the language of the statute. So when we charge this jury , unless your

idea of having the interest --

THE COURT: Be a judgment decision as opposed to a jury decision .

MR. YETTER: Yes. That's an interesting idea. I'm not saying -- I can't comment . Smarter people than I are going to be thinking about that overnight, Your Honor.

Then it's going to be -- the jury is going to have to decide this and you're going to give them the actual language. And unless we change the language, which is what Morgan Stanley is saying we have to do, the jury's going to decide the way the s tatute says.

Okay. Second point . So this is -- the first point is that's what the statute says and that's what the PJC tells us to do. And on that point, Your Honor, both sides before -- actually in February , exchanged jury charges . And not surprisingly , both sides have the jury charge that says exactly this. It says the -- it track s the language of the statute.

So you have full purchase price plus interest , and then you subtract income and sales proceeds. S o that's what both sides did.

And, Your Honor, I can give that to

you if you're interested. But I'll represent to the Court that Morgan Stanley's and the FDIC's proposed jury charges exchanged on February the 20th, 2015, say exactly what I just said.

Okay. Second point. The second point is that the text of the statute requires us. And there's lots of good reasons for that. So what the text says, Both sides agree that principal that is repaid is called -- is income.

And the reason I'm focusing on the language, Your Honor, is because the Texas Securities Act has compensation and income, two different words in two different parts. They don't mean the same thing.

So compensation paid is essentially the purchase price, what you paid for the security. Then you add interest. Then second step, you take out the income, which is both the interest you actually earned and the repaid principal and the sales proceeds. So that's the second step.

Both experts' reports, Your Honor, call repaid principal income. It can't be the same thing. It can't be income and compensation paid under the statute because, as the Court knows, you don't -- you can't do that. You can't have two

words that mean the same thing or else the legislature -- and, of course, the legislature could never have done something irrational or unreasonable. Not our legislature. So we, obviously, have to -- can't do it -- can't interpret it that way.

So the bottom line is, Your Honor, the statute says income is subtracted after you add interest in step two, not in step one. In fact, what we've heard from Morgan Stanley -- and I think they've done it very effectively -- they talked about, Oh, it's a windfall and they're getting double recovery.

And, in fact, it's not. It's working just like the legislature said. First you have the amount you paid plus interest. And step two is taking out the income. What they would like to do, Morgan Stanley, is take out income twice on both sides of the equation.

What they really are saying --

THE COURT: I'm sorry, I missed that part. How is what they're arguing taking out income twice?

MR. YETTER: Okay. Because step one is consideration paid plus interest under the

statute. And step two is then you take out income. You subtract income, which is interest, repaid principal and sales proceeds.

What they want to do is also take out repaid principal from step one before you add interest. And so they would be taking out twice.

THE COURT: All right. It sounds to me like what they're saying is he would take it out at the beginning, which then would ultimately reduce the base amount on which the interest is calculated.

MR. YETTER: True. But they're taking out income on both sides of the equation. They're taking out the prepaid principal on step one.

THE COURT: Right.

MR. YETTER: And then the income and the sales proceeds -- I'm sorry, the interest and the sales proceeds on step two. So they want to have income on both sides of this equation when the statute says it's only in step two.

THE COURT: Okay. Keep going. What else?

MR. YETTER: All right. So what they really are saying, Your Honor, is they're saying

for this type of security -- and, again, the Texas Securities Act covers all types of securities -- for this type of security that is called -- that they call an amortizing security where you get paid your principal along the way, you have to have a different rule.

And the Texas Supreme Court has said no, you don't do that. They have one securities act. It may be better suited for certain securities than others, but it's one rule. The legislature has that prerogative.

Here, Morgan Stanley wants to say you have to have a different damage calculation because the nature of the security they're claiming is different. And they cite to two cases, Nomura and Schwab. And with all due respect to very capable counsel, neither case held, as I believe the Court was told, that the amortizing method is the legally required method. And I'll explain briefly why.

Schwab wasn't even a Texas Securities Act case. It was a California statute. It has different wording in significant ways. It wasn't even -- and they ruled on summary judgment that the different California statute, which apparently has different legislative intents, has a different way

of doing things.

That's not what the Texas Securities Act says. In a very specific way there's a -- in the Texas Securities Act, very briefly, Judge, it says compensation paid plus interest thereon. "Thereon" being compensation paid.

The California act doesn't say that. It doesn't have the word "thereon." So that California Judge on summary judgment made a different ruling that we don't believe has anything to do -- that in any way requires the Court to make a ruling one way or the other in this case.

Nomura, which is a Federal court case, both parties agreed to apply this amortizing principal. The Judge never made a ruling one way or the other. She simply said, This is what the Plaintiff and the Defendant agree upon in the approach and I'm going to enforce it. So there was no ruling either way.

We're not -- we don't believe that there's any case under the Texas Securities Act or specifically under the Section 12 that deals with this issue foursquare. But we think in this case, Your Honor, the statute is what the Court 's going to follow. The PJC is what the Court is going to

charge the jury on . And the purposes of the statute is what you're going to be guided by, which is point three.

The purposes of this statute -- I'm on Slide 5, Judge.

THE REPORTER: Going to what?

THE COURT: "I'm on Slide 5," he said.

MR. YETTER: I'm sorry, let me slow down.

The purposes of this statute , which are absolutely clear because the Supreme Court eight years ago in 2007 said, Our state's blue sky laws, which is what this statute is a part of , have three -- and I'm quoting ; this is a Citizens Insurance case -- quote, "long-standing purposes ." This is our Texas Supreme Court.

THE COURT: You know what ? With all due respect, I've read the slide and I get -- the statute is there to encourage people to comply with the blue sky laws.

MR. YETTER: Exactly. And so what this -- what Morgan Stanley is saying is if it slightly -- if it is not precisely compensatory , then it can't survive. Well , in fact, the Court

has said it needs to incentivize and it needs to deter.

And I'd make one other point, Your Honor, that's not actually reflected on this statute -- on this slide. Is that the Texas legislature basically decided that when someone misrepresents, causes -- makes misrepresentations in selling a security, the legislature is going to come in and compensate that victim ized investor by awarding them the Texas statutory prejudgment interest amount, which at least in today's world can be far more than the agreed interest that they thought they were going to get on their security.

So, for example, here when securities are purchased and the interest rate is, perhaps in many of these, much less than 6 percent, the Supreme Courts -- I mean, the legislature said you're going to get 6 percent the entire life of that security.

Now, Morgan Stanley could just as easily be in this courtroom saying, Well, that's overcompensatory. And so that's inconsistent. And so they could only get the interest that they thought they were going to get when they bought the security.

The legislature's totally entitled to do that. They're totally entitled to encourage compliance and deter violations, and they're entitled to create incentives.

So concluding, Your Honor, actual -- we actually think that the approach we're using is the actual compensation paid approach plus interest, and then deduct the income. That's what we believe the statute requires. That's what we believe you're going to -- the Court's going to charge. And there are lots of good reasons to do that.

THE COURT: Now, whether I make that decision or the jury makes that decision, I think it's going to be a readily ascertainable number either way. Just math. That is something that we could fix post verdict fairly easily.

MR. YETTER: Absolutely. And if you don't want to have to -- if we're right or even if they're right, it will all come out in the trial. And afterwards you can take a fresh look if you want to take a fresh look at it, Your Honor. Or maybe even we'll take the approach that you'll apply the interest. And that can happen all after trial, but we need to have -- after the verdict, but we need to have

the evidence before the jury.

THE COURT: Now, but this is a motion in limine point. So they are arguing that there shouldn't even be testimony at the trial --

MR. YETTER: That's what they're arguing.

THE COURT: -- about the -- your calculation.

MR. YETTER: How do we get a ruling from the jury if we don't have the evidence in the trial record? Unless we want to do this again. And I don't think anybody wants to try this case again, Your Honor. We have to have the evidence in the record.

Again, as you said, either you can apply this as a matter of law afterwards if that's what we consider -- you consider to be appropriate or you can always fix it in a post-judgment motion.

THE COURT: Right. So how is this -- so why would this be appropriately a limine point? Unless you're -- I mean, you're really asking me to make a legal decision, sort of a summary judgment -- or a Rule 166 motion to decide something as a matter of law.

MS. SESHENS: What we think, Your Honor, contrary to Mr. Yetter's portrayal of this whole

issue, that you have to decide it and you have to decide it before anything goes before the jury for this reason. Mr. Yetter has characterized this whole amortizing principal methodology as Morgan Stanley's.

To be clear, Morgan Stanley does not think there are damages in this case. We have not put forth an affirmative damages expert. We have responded to the FDIC's Ms. Rutledge, the FDIC's own expert. All these criticisms of the amortizing methodology, which are incorrect and I'll get to those in a moment, are Ms. Rutledge's method.

And the reason we need a motion in limine ruling now is that she otherwise has two opinions. She has damages opinions that vary in the range of 25 to 30 million dollars. And the jury can't decide which opinion is legally tenable. The Court has to make that determination.

It can be -- we think it would be clear legal error for the jury to decide which methodology under the statute is appropriate. And the jury cannot be left to choose between Ms. Rutledge's two opinions.

So unless they are pulling one, in which case we challenge it on different grounds, Ms. Rutledge has put forth the amortizing principal methodology. Ms. Rutledge has backed out principal

repayments from the amount on which she has calculated prejudgment interest. She has not backed out income twice. That is not what is going on here.

But to be clear, we do not think that this is an issue that can go to the jury. How would the jury decide whether it's her amortizing principal method or her full-principal method? It's clearly a legal question of how the statutes work.

MR. YETTER: I'm happy to respond to that. I don't want to interrupt her presentation, Your Honor, but if you'd like a response to that, I'll be happy to.

THE COURT: Are you finished --

MS. SESHENS: I just want to clarify a few points, Your Honor. That is why this jury charge issue, to our mind, is a total red herring, because we don't think this opinion can even go to the jury. Nobody is saying the charge shouldn't reflect what the statutes say. The point is the jury cannot make this determination. It is a legal question that has to be decided by the Court.

Now, in terms of how Mr. Yetter has described Ms. Rutledge's methodology, we think that there were some errors in that description that I just wanted to clarify. I think Your Honor actually picked

up on it. But it is not the case that income is being backed out twice.

To be clear, what Ms. Rutledge has done is taken in her amortizing method the principal, the consideration paid, minus interest. The way she determines the interest is to reduce the consideration paid by principal repayment and calculate interest on that amount. So it's consideration paid, minus principal repayments, interest calculated on that declining balance. Those two are added together.

Then she takes out -- and this is Ms. Rutledge, this is the FDIC's expert. She then takes out income, which she defines as income and principal repayments. And so that is how she takes those out at the end of the statute.

The Nomura case, for example, which is a Section 12 case where the Court awarded Section 12 damages using the amortizing principal method, the Court took the income out from the consideration paid, and then didn't take it out -- I'm sorry, took the principal payments out from consideration paid, and then only took income out at the end. But mathematically it's the same thing.

But there's no double counting of income. That is the point I want to make clear to

Your Honor. I think Your Honor understood that by your questions . It is only the basis on which prejudgment interest is being calculated that is at issue.

Just two quick points, Your Honor.

THE COURT: Does anybody have like a ready -- or do the reports themselves have the ready, the formula -- an actual display of the formula that they are using so I can see where -- see what that actually look s like mathematically?

MS. SESHENS: Yes , I believe -- I don't want to speak for the FDIC , but I think both damages experts have put into numbers how these things work. Our expert , just so Your Honor knows , simply follow ed Ms. Rutledge's methodology . He did not opine on whether that was proper or not. H e just said if you take her methodology , here's how the numbers change . But there are actual numeric calculations that reflect how the numbers are impacted by this.

THE COURT: So, I mean, I agree with you that the jury is not going to be the one that decide s which methodology is used, I don't think. I mean, that doesn't make any sense. I don't know -- maybe Mr. Yetter can speak to this as well , but

I don't know that we're asking them to make that decision.

We're asking them -- I guess what I'm saying is if we let Ms. Rutledge testify as she proposes, then she would be saying this is what the damages are and whatever that damage number is at the end of the day, if the jury agreed with her, that would per se include whatever prejudgment interest they were entitled to. And if I bless that, then that would be the end of it.

Versus her opinion -- her giving an opinion as to these are what the actual damages are, and then we ultimately conclude the right methodology is to -- at the end of the trial, then figure out which basis to -- which manner is the correct way to calculate the prejudgment interest.

MS. SESHENS: I think, Your Honor, given the statutory language, it would seem it has to be the former. It's part of the statutory formula. It's not like you assess, for example, contractual damages or tort damages, you know, and then there's discretionary statutory interest where there's mandatory statutory interest. And the Court can do the simple math.

This is actually a statutory

interpretation question . How does this statute work as a legal matter ?

Putting it into numbers is not so hard once you make that determination. But that's the question we 've put before the Court now . It's the question we think the Court has to decide before trial because we don't think the jury can make that determination.

(Sotto voce discussion between counsel)

MS. SESHENS: Your Honor , my esteem ed colleague just made the excellent point that when you think about from the charge , you know , they're not -- the jury is not going to be asked to calculate the different components of the damages formula . There's going to be a damages number that's been put before them and they're going to pick it or they're not.

THE COURT: Or it's going to be a blank .

MS. SESHENS: R ight . And so it's not going to be the case that they're going to go and pick and choose and figure out how the statute actually works . They're going to listen to the opinions --

THE COURT: No . I think we're saying the same thing in part. In that we're never going to ask the jury to decide , Do you do it this way or do you do it that way ?

It's going to be the experts ought to be able to opine this is what the damages are. But the Court 's going to decide -- the Court will have to decide whether it's an issue of -- the Court will decide the -- I guess what we're saying is if I agree with you -- or whoever I agree with , the other way is simply not -- the other analysis is just not relevant because it's a legal determination.

MS. SESHENS: That 's correct, Your Honor. And that is how we see this issue very clearly. And I would just note before I sit down and yield the floor to Mr. Yetter that you didn't hear the FDIC say anything at all about Section 11 . Their whole presentation is about the TSA. They have no argument in response to Section 11 .

They've said nothing about Section 12. Section 12's language about consideration paid for the security plus interest thereon is exactly the same as the TSA. You can't reconcile their position . If it's amortizing

principal under Section 12, it has to be amortizing principal under the TSA. There's nothing in the statute or in its purpose that says otherwise.

Thank you, Your Honor.

THE COURT: All right. Very briefly. Just for the record, it's 4:39. So I don't know how much further we're going to get.

MR. YETTER: Okay. Let's just spend five more minutes on this, Judge. What is your -- do you have any -- what is the question that you need answered?

As a matter of evidence, the evidence needs to come into the trial for the jury to make a determination to answer the question. The question that the FDIC has said -- I'm sorry, that Morgan Stanley has said, the FDIC is entitled to recover the consideration paid for the certificate plus interest thereon at the legal rate from the date of payment. That's step one. Comma, less the greater of. And then they go into income, the value of the certificate at the time they sold it and the actual consideration received for the certificate. Dot, dot, dot.

So the point is they have -- Morgan Stanley has in their jury charge exactly the same

formula that we have. Now , until the Court suggested that maybe the Court can decide this after the verdict , we assumed like in every other securities case the jury is just going to apply that simple formula : Consideration plus interest , minus income . And that's , we think , very much within the jury's province. They just have to have evidence.

Now, our expert has given two approaches knowing , of course , that Morgan Stanley , there's lots of these cases . We know their approach. She said , Well, if they are convincing and you take their approach, this is how you calculate it. Our approach , we believe , is the actual compensation approach and this is how you calculate it . There's nothing inconsistent with the fact that she's given numbers for both. Experts do that a lot.

So our point basically , Your Honor , is this is not a motion in limine issue. At best , maybe this is a charge issue that the Court deals with on the charge . But the evidence has got to come into the trial for the jury to be able to decide.

THE COURT: I don't think it can be a charge thing because I think I have to make a

decision as to the right methodology legally pretrial, it sounds to me. Because otherwise the evidence won't be in front of the jury if I decide that it's --

MR. YETTER: So --

THE COURT: -- that it's -- well, either way, I guess.

MR. YETTER: Our position, Your Honor, our expert's prepared to give both numbers, both approaches.

MS. SESHENS: And as I said, Your Honor, we think that's legally untenable.

MR. YETTER: It happens in trials all the time where you have a more complicated trial where there's some valuation issue and there is an issue that the jury may accept this particular fact over that fact and a damage expert gives alternate damage theories. Frankly, it's happened in every complicated case --

THE COURT: Alternate damage theories are if you've got different theories that all fit under the same legal analysis. But here I think it's a legal question first that will direct the nature of the expert's testimony.

MR. YETTER: I hear where the Court's

coming from. Obviously you 've heard our arguments why as a legal matter the approach -- the actual compensation approach is what the statute says is what we think the Court is going to charge the jury. So the Morgan Stanley position is going to have to require a ch ange in the language of the statut e or a change in the charge to the jury.

But, again, we submit that you could deal with this on -- at the jury charge or at post-judgment rulings . But if the Court's inclined to make a decision earlier than that , we're certainly prepared to --

THE COURT: I think that would be tough for the jury because it's a -- what they would hear is , Here's one mathematical formula , here's another mathematical formula. B ut then how do we instruc t them that this is how the Court ruled ultimately in -- in other words , how does the question change in the jury charge depend ing on how I make a ruling, say at the charge conference , that would direct the jury as to which approach to take ? That's not clear to me.

MR. YETTER: So for what it's worth , Your Honor , we're comfortable if the Court wants to make a decision now . We think the statute is

absolutely clear for the reasons that we've already given to the Court . We think the full compensation -- actual compensation approach is correct.

THE COURT: Give you another 30 seconds if you want.

MS. SESHENS: Certainly, Your Honor . Thank you .

You've obviously heard us on the fact that we think it 's a legal issue. I would just note in closing that when Your Honor looks at this issue , it is a legal issue. There is not a single case that the FDIC has cited to you that supports the full-principal method . And all of the cases that have been decided in this context and even in other context s have supported the amortizing principal method. We , therefore , think there is no support for the FDIC's position.

Thank you, Your Honor.

THE COURT: Tell me one more time , Mr. Yetter , where should I read -- where should I look for this? You just say it's the plain language of the TSA.

MR. YETTER: So there is no Texas case on this statute in this context, Your Honor. There is a statute that has a simple formula. If

the Court would like , we can -- I tried to do -- I tried to kind of distill all this down i nto our presentation . I'm happy to give you a hard copy of that . I think we may even have it handy.

But the bottom line is , as the statute says , it's a two -step process. We're handing up to the Court right now a copy .

May I approach, Your Honor?

THE COURT: Sure.

MR. YETTER: I know the Court doesn't like paper , but I thought this might be a little helpful . But the bottom line is the statute has a clear two-step formula . To the exten t that Morgan Stanley is correct , they have to change the formula for these types of securities.

That's not what the law says. There's one securit ies act . There's one form ula. It is a two -step formula where income is take n out in the second step. Their expert calls repaid principa l income, which is what it is ; and it doesn't come out of the first step.

And that's our position, Your Honor. I know you can't get any more certain than the clear words of our state legislature in every case. This is one where actually I think it is pretty

clear, Your Honor.

MS. SESHENS: Your Honor, just one --

MR. YETTER: Thank you for the time on this issue.

MS. SESHENS: -- one point to conclude. Well, perhaps really two.

We fundamentally disagree that the jury charge would have to be changed at all. The statute is what the statute is. The question before the Court is how does one interpret that statute?

The jury is not being asked to do that. The jury will be presented with evidence that is consistent with the interpretation that the Court determines.

The second point I would note for Your Honor is the Nomura case that we've talked about had a Section 12 claim, but also had a Virginia blue sky claim, which is the TSA, if you will, of Virginia that also contained the consideration paid plus interest thereon from the date of payment language. And the Court applied, again, the amortizing principal methodology.

So while Texas perhaps has n't grappled with this issue, other courts have. The

California statute in Schwab is not different. It has different language. It is not substantively different. And the Nomura case dealt both with Section 12 and also with blue sky laws.

Thank you, Your Honor.

THE COURT: Okay. I think it's fair for me to look at that case law now that I have a better grasp of what the argument is about on this issue.

MS. SESHENS: Your Honor, on that note, one thing. Would it be helpful to Your Honor, and both sides could do this, if we provided you with the cases so that you have them accessible? Or do you have them handy?

We realize we should have thought about this before we came in. There's a lot of cases we cite, there's a lot of motions. To the extent it's helpful, I'm sure -- I don't want to speak for the FDIC, but I'm sure we'd all be happy to send a drive over with everything electronically if that would aid the Court.

THE COURT: You know what? It's just as easy for me to find them on Westlaw as long as they're cited in the papers.

MS. SESHENS: Okay. As long as

that's easy enough for you , that's fine. We just wanted to offer it.

THE COURT: All right . Let's see if we can knock out one more real quick. Is there a short one that we could skip to maybe , or two or three?

MS. SESHENS: Hold on one second, Your Honor.

THE COURT: How about use of a smart board at trial , is that --

(Laughing)

MR. YETTER: So , Your Honor, I'm going to withdraw that because we've tried it and the courtrooms are just not set up effectively. You have to basically kind of -- you can't really fit it in here very easily and you have to kind of do it over the bar. So we won't use the smart board. We have good technology in the courtroom.

THE COURT: All right. How about application of the standing order of limine , anybody opposed to that?

MR. YETTER: We're good with that one, too, Judge.

THE COURT: Well --

MR. YETTER: Is there something there

that we have a problem with?

MR. HOLTON: Well, Your Honor, Mark Holton.

THE COURT: How are you? I haven't talked to you in a while. Are you doing okay?

MR. HOLTON: Fine, sir. Thank you very much.

In that regard, we do not have an objection to apply application of the limine order. Of course, we do perhaps have a disagreement with Morgan Stanley about whether that in limine order precludes the admission of certain evidence that we think is not subject to it, but which they have suggested is.

I'm happy to go into that. It's their motion. It might be one to knock out quickly. I don't know. It's a rather discrete one, the Bank of America settlement document. But that's our qualification on the in limine order.

THE COURT: Hold on one second. I'm sorry, so what's the settlement document that we're talking about?

MR. HOLTON: Yes, sir. Your Honor, this is a motion by Morgan Stanley to preclude the admission into evidence of a settlement agreement

between Countrywide and the Department of Justice resolving claims relating to RMBS .

And I do need to give a little bit of background here, Your Honor. You've heard argument today about Dr. James . And Ms. Seshens noted that one of the things that Dr. James tries to do -- and we acknowledge it's related to los s causation , as I think Your Honor has recognized -- is to say that he has compared the loans that our underwriter found to be de fective against a controlled set of loans and says , When I do that comparison , the performance is the same in both. So these underwriting defects didn't cause the loss.

THE COURT: Right.

MR. HOLTON: Well , obviously , Judge , that only works if the controlled set of loans doesn't have the defects associated with it. And Dr. James fails to make any showing that those loans are free of defects. And the loans that he chose were loans sold by Countrywide -- excuse me , loans sold to the GSE s Fannie Mae and Fredd ie Mac, which we made reference to before.

And we -- Dr. James has not made any effort to actually show that that controlled set of loans is free of the defects that our underwriter

found in the loans at issue here.

But we're trying to go a step beyond that, as we think we're entitled to , Your Honor , as a matter of rebuttal evidence. As Dr. James admits , his control led set of loans almost certainly contains a lot of loans from Countrywide because Countrywide was the biggest seller of loans to the GSE s during this relevant time period.

And that's whe re the settle ment agreement comes in, Your Honor. C ountrywide admitted in its settlement agreement with the Department of Justice that it sold defective loans to the GSE s during the relevant time period. So not only has Dr. James f ailed to do anything to demonstrate that his loans set -- his control led set is free of defect , we actually have good evidence that it 's not.

And that 's where the agreement between the D epartment of Justice and Bank of America , which of course now owns Countrywide , comes in because it was in that agreement , an annex to that agreement , where Countrywide , Bank of America explicitly admitted that we sold defective loans in violation of -- we made misrepresentations and sold defective loans to the GSEs .

These are the very loans that are in the control set that Dr. James is using to allegedly show no los s causation . I think it obviously blows up that analysis entirely. Now, they said --

THE COURT: And so the limine point dealing with settlement agreements is what you 're addressing ?

MR. HOLTON: Yes, sir . Because they've -- I don't -- again, don't want -- Ms. Seshens is well able to speak for herself , but as I understand the argument , they 've said, Well, as a matter of sort of policy or what have you, it's a settle ment agreement , and so that shouldn't come in .

And, of course , our argument is, Judge, well, it's not a settlement agreement involving Morgan Stanley . We're not suggesting that it is . It's a settlement agreement involving Bank of America.

THE COURT: So you say it has some relevance . So to the extent they're seeking to exclude it simply under 408 as a settlement agreement , that shouldn't happen ?

MR. BURNOVSKI: Your Honor , if I may ?

It is our motion. I'm happy to -- I don't want to interrupt, but I'm happy to explain sort of the bases for the motion, if that would be helpful.

THE COURT: Sure. Real quick.

THE REPORTER: What is your name?

MR. BURNOVSKI: Brian Burnovski.

THE REPORTER: Okay. Thank you.

THE COURT: Spell the last name.

MR. BURNOVSKI: B-u-r-n-o-v-s-k-i.

THE COURT: Wow, I would have gotten every part of that wrong.

MR. BURNOVSKI: It's not an easy one, Your Honor.

So what the FDIC is seeking to admit, Your Honor, is a settlement agreement by Bank of America with a number of government entities, including the U.S. Government and various state attorney general, as well as a statement of facts that was ended to the agreement.

And just to -- as a preliminary matter, just to clear up a couple of things that Mr. Holton said. Contrary to the FDIC's characterization of the settlement, it is not an admission by Bank of America. The settlement agreement itself, which is Exhibit 15 to Morgan

Stanley's opening brief, states that Bank of America, quote, unquote, acknowledges the facts set forth in the statement of facts. It doesn't say anything about an admission.

Second of all, Your Honor, the statement of facts doesn't reflect any conclusive finding of fact by any of the government entities or parties to the agreement. Again, the settlement agreement in Paragraph 21 C states that the settlement was being made, quote, without any adjudication or finding of any issue of fact or law.

So that's just by way of context, Your Honor. And the bases for our motion for excluding the settlement agreement are twofold. First, it's not relevant. And second, it's prejudicial.

So first on relevance, Your Honor. As you heard, the settlement is being offered by the FDIC in order to support a criticism of Dr. James's analysis, and specifically a criticism that the control group could use to compare to loans at issue in this case is not clean, if you will.

The FDIC is incorrect. As I said,

first of all, the way in which they're using this settlement is inappropriate because, again, it's not an admission and it's not any finding of fact. A settlement is just that, a settlement of disputed claims by two parties.

THE COURT: Uh-huh.

MR. BURNOVSKI: And unproven allegations of misconduct are irrelevant in addition to being hearsay, Your Honor. Second, in any event, the settlement doesn't support Dr. Snow's criticism. The portion --

THE COURT: Doctor?

MR. BURNOVSKI: I'm sorry. Dr. Snow is the FDIC's rebuttal expert to Dr. James. And the criticism of Dr. James is being offered through Dr. Snow.

And the portion of the statement of facts that the FDIC is relying on is a statement that says -- and it's just one small portion of the statement of facts, which includes a number of other issues that are completely irrelevant to this case, and neither the FDIC contends otherwise.

And the portion they're focusing on is a supposed admission -- which, again, we don't believe is an admission -- that Countrywide or that

Bank of America as the successor to Countrywide sold loans to the GSEs Fannie and Freddie, and that many of those loans were, quote, defective and/or otherwise ineligible for sale to the GSEs.

But what that says, Your Honor, it's important to sort of focus on what that means. The fact that loans were in eligible for sale to the GSEs may be a problem for Bank of America, but it doesn't pose any problem for Dr. James's control group. And that's because -- simply because the loans didn't meet the underwriting standards for the GSEs and were ineligible -- were, therefore, ineligible for sale to the GSEs is completely irrelevant in this case.

Because the offering documents for the securities at issue in this case specifically disclose that the loans in this case were underwritten pursuant to standards that were different from the GSEs underwriting standards and, in fact, were, quote, less stringent than the GSEs underwriting standards. So, therefore, Your Honor, it simply doesn't prove what they're trying to prove with the settlement.

Second of all, even if there was some, quote, unquote, defective loans in the --

that were sold to the GSEs, again, that doesn't show that there's anything wrong with the benchmark.

For example, Your Honor, if the GSEs requested that -- as part of their post purchase diligence efforts that the loans be a repurchase by Countrywide and the loans were, in fact, repurchased, they would n't have been included in Dr. James' benchmark because he simply excluded any loans that would be repurchased.

Second of all, Your Honor -- so that, Your Honor, is in a nutshell why we believe the settlement agreement and the statement of facts are irrelevant.

But second of all, it's also highly prejudicial. The FDIC's argument is that it can't be prejudicial because Morgan Stanley was not a party to the settlement agreement. But that's not true, Your Honor.

The same concerns regarding juror confusion and unfair prejudice that an imate legions of decisions that exclude settlement agreements are similarly present here.

For example, a juror may hear about a 10-billion-dollar settlement with the U.S.

Government over conduct relating to RMBS that overlaps substantially with the allegations here and they simply assume that, Well, Morgan Stanley must have done the same thing because all Wall Street banks are the same.

Second of all, such an improper and unfounded inference will be particularly prejudicial here because, as I mentioned, Bank of America itself didn't admit any wrongdoing under that settlement agreement.

Moreover, the fact that there are no conclusive findings of fact in the statement of facts is important because the jury is likely to find that just because a settlement is with some government entities, it would take on undue significance in the minds of jurors.

And compounding that, Your Honor, is the fact that the settlement agreement itself references a separate settlement over claims that the FDIC brought against Bank of America on behalf of various failed banks, including Franklin Bank.

And I'm sure Your Honor can imagine the confusion and prejudice that would result from knowing that Bank of America has settled a billion-dollar claim that is very similar to the

claim at issue here. Or settled for a billion dollars with similar claims to those at issue here.

Now, the FDIC offers to redact -- in a footnote, offers to redact references to the FDIC in the agreement. But, Your Honor, for the reasons I've articulated, Morgan Stanley doesn't believe that that even begins to address the prejudicial effect of admitting the settlement agreement. Particularly given its limited, if any, relevant probative effect.

THE COURT: Would you elaborate on the -- you think they're offering it for the truth or they're offering it to show something other than the truth of the matter asserted therein?

MR. BURNOVSKI: I believe they're absolutely offering it for the truth, Your Honor. It has no relevance unless you accept as true the statement in the statement of facts that Countrywide and/or Bank of America sold, quote, unquote, defective loans to the GSEs. Only if you accept that as true is it at all relevant in this case.

THE COURT: And so setting aside the settlement agreement, this evidence exists elsewhere? The evidence that they're trying to

show, does that exist outside of the settlement agreement?

MR. HOLTON: Affirmative evidence of defects in the comparative set, Your Honor, I don't believe that we have any other evidence of that.

THE COURT: So how would you -- okay. So that if I exclude this document, you're saying, then you don't have that argument to make?

MR. HOLTON: Well, our expert, Dr. Snow, points out in his rebuttal that Dr. James, their expert, makes no effort to demonstrate that his control set is, in fact, free of defect. So that argument is there. And I don't think they're contesting that Dr. Snow can make that point, which he will make and made in his expert report.

But the next step here that we think is critically important to demonstrating just how flawed this analysis is, and you've heard from before how important this issue can be, this loss causation issue, how flawed this analysis is, he said yes. I don't know. Acknowledgment, admission, statement of facts, findings of fact, it all sounds a little bit like, you know, dancing on the head of a pin, Your Honor.

Countrywide or Bank of America

acknowledged that they did this. And they acknowledged not just that the loans were not consistent with the guidelines of the GSEs, but that they were defective. So it's a little bit of a misread to say -- to read it as narrowly as Counsel has.

As far as the prejudice goes, Your Honor, really, truly, the important part of this is Countrywide's acknowledgement. We can present that in a way that would eliminate any reference to a settlement agreement --

THE COURT: How long is that section? Is it not just a paragraph?

MR. HOLTON: It's very short. It's two paragraphs, Your Honor. It's two paragraphs. And we certainly could distill that and offer that acknowledgment, admission, whatever you want to call it, to the jury without the context. We don't think this is necessary without the context of the settlement agreement and the 10-million-dollar settlement that Bank of America entered into and all the rest of it.

So if the prejudice that they're talking about is something that concerns Your Honor, I think it could easily be remedied while

still allowing us to put in what's really the crux of the evidence that we want to put in from the agreement, which is the acknowledge ment, admission by Countrywide that it sold defective loans. The biggest seller of loans to the GSEs during the relevant time period, that it sold defective loans to the GSEs.

And opposing counsel is, of course, free to make argument s to the jury about why that evidence should be not credited or ignored, but that's really, I think, all that his arguments really go to aside from the prejudice issue. So we think that evidence certainly should be specifically admitted.

(Sotto voce discussion between counsel)

MR. HOLTON: So my learned colleague has reminded me that it's really not hearsay, Your Honor, because what we're doing is demonstrating that there was an investigation that their expert should have done and didn't do to try to demonstrate that he should have seen that these loans -- that this acknowledge ment by Countrywide had done something to investigate that before putting this before a jury and before the Court and

saying, I've got a clean control group over here of loans.

Not only did he fail but he had reason to think that there was a problem and he didn't do anything about it. So it's not for the purpose of necessarily for the truth of the matter being asserted. I t's that it's another example of a faulty process that Dr. James went through to identify the control led set of loans that he purports to identify as being clean of defect.

If Your Honor has any questions , I'm of course happy to answer them .

MR. BURNOVSKI: A nd couple of points in response, Your Honor.

THE COURT: Sure . Real quick .

MR. BURNOVSKI: S ure. Just take them in the reverse order. T he last point that Mr. Ho lton made that it's not being offered for the truth of the matter , I respectfully disagree . It absolutely is . And they're fr ee to cross-examine Dr. James without having to rely on the settlement agreement.

THE COURT: I'm not going to get hung up on the hearsay part because experts routinely can and do rely on hearsay .

MR. BURNOVSKI: Okay. Then, Your Honor, still the initial point Mr. Holton made is that this is necessary in order to show that there was a process failure by Dr. James. Again, they don't each rely on irrelevant and prejudicial evidence to do so. They note that it can be redacted to just those two paragraphs.

I'm not sure as a practical matter how that could possibly work, Your Honor, given that the very fact of a settlement with the government is prejudicial. Whether or not the findings in that are characterized as an admission or as an acknowledgement of a finding as legal significance --

THE COURT: Let me interrupt. Can I see that page, please? I just want to see what it looks like.

MR. HOLTON: Of course, Your Honor. I must say that I have -- here --

MS. SESHENS: We have a clean --

MR. HOLTON: You have a clean copy. Okay.

MS. SESHENS: Your Honor, we have a clean copy for you.

MR. HOLTON: I didn't want to give

you one with my notes on it.

THE COURT: Well, you did want to give me the one with your notes on it, but you thought it's not fair.

(Laughing)

MR. HOLTON: I didn't think it was appropriate to do so, Judge. It's just a couple of brackets, actually. So do you -- here -- okay. Fine.

THE COURT: Off the record for a second while all the cross talk.

(Discussion off the record)

THE COURT: Go ahead.

MR. BURNOVSKI: I just wanted to make a point. Your Honor's mentioned that you're not going to get hung up on hearsay because experts rely on hearsay all the time. And while true, that doesn't mean that the evidence should be admitted into the record. I just wanted to quickly draw that distinction. Thank you.

THE COURT: That is a fair point that in and of itself it doesn't -- well, let's see, if he relied on it. Well, that's a discovery issue. That's a fair point as to whether it actually comes into evidence, but whether he can refer to it or

talk about it as the basis of his opinion --

MR. BURNOVSKI: Understood, Your Honor. I just wanted to draw that distinction.

THE COURT: That's fair.

(The Court reviewing documents)

THE COURT: I'm looking for the beginning here where it says the statement of facts -- hold on one second.

MR. BURNOVSKI: Your Honor, may I approach? Well, it might be helpful to have the settlement agreement as well as the annex together, if that's what Your Honor was --

THE COURT: Sure. If you've got it, I'll take a look at it. Go ahead. Come on up.

MR. BURNOVSKI: This is the settlement agreement, Your Honor. And this is the complete annex and the relevant page it's on, Page 27.

THE COURT: Let me ask you a question. It says statement of facts and there's a settlement agreement. What is the evidence or how does one know that this is, in fact, true as opposed to -- or an admission by Countrywide, for example, as opposed to just a finding by -- by who, by the what, the DOJ or SEC or somebody like that?

MR. HOLTON: I think that the Department of Justice was the princip al negotiator. Your Honor , again , I think -- I don't have it i n front of me , but I think the settlement agreement explicitly notes Countrywide 's ac knowledgement of the statement of facts. A nd that was a semantic discussion that we had had previously.

I'm not sure where in the agreement that is. I would have to take a look at it if I could try to find it . But Your Honor --

MR. BURNOVSKI: Your Honor , it's -- recital I of the settlement agreement is the portion that talks about Bank of America acknowledging and not admitting the statement -- the statements in the statement of fact. And I would add as well , Paragraph 21 C , contrary to what Mr. Ho lton just said , indicates explicitly that there is no finding of fact.

THE COURT: Then what does it mean to acknowledge the facts set out in the statement of facts in English ?

MR. BURNOVSKI: I think , Your Honor -- I'm sure that provision was he avily negotiated . And I think the fact that it's not an admission is meaningful and it's more than just a semantic

meaning. And obviously I don't mean to not answer Your Honor's question.

THE COURT: No. I --

MR. BURNOVSKI: We weren't involved in that settlement agreement and I'm not sure what it is. But the fact that it -- I know what it's not, and it's not an admission. And I would add to that again the fact that there is expressly no finding of fact --

THE COURT: Yeah.

MR. BURNOVSKI: -- by the government.

THE COURT: I mean, it could have said they have read the statement of facts. It also could have said they admit or adopt the statement of facts. I tend to agree with you that it was not something done lightly.

COURT'S RULING

THE COURT: All right. I'm going to rule that pursuant to 403, the danger of undue prejudice greatly outweighs the probative value of this document. And I will exclude the document itself. If the evidence -- the information may very well be pertinent to the expert's analysis and opinions, but you'll have to get at it another way.

MR. HOLTON: Yes, sir.

THE COURT: Very good. We'll leave it there. Are we scheduled to resum e this at some point in the future?

MS. SESHENS: Not presently, but I was just going to ask Your Honor if maybe you wouldn't like to, but I suppose we probably have to.

THE COURT: Yeah. No. I would be happy to. Is 2017 good for you?

(Laughing)

THE COURT: Let's see. We're set for trial at the very beginning of January , no? Or right after July --

MR. YETTER: July . July.

MR. CALLAHAN: July 6th.

(Multiple speakers)

THE COURT: Yes, the beginning of July -- right after the 4th of July.

MS. SESHENS: Correct.

THE COURT: I'm sure we could find some time between now and then to set aside a day to work on these things . And then I guess we'll have to -- whatever we can't finish , we'll have to pick up -- you know, as the trial starts , spend a day or two , hopefully not more than that , on pretrial matters.

All right. I guess let me just let you talk to Veronica. Veronica and I will visit the next day or so. And if you then would follow up with her and see what works with your schedules. And if we can squeeze in a day between now and the beginning of trial -- before that week of trial, I could do that.

I'm going to be gone the week of -- from Saturday through the following week. So that leaves us with the second half of June. We ought to be able to find some time in there at some point. I know I've got a couple of trials scheduled, but we'll do the best we can.

MR. YETTER: Thank you, Judge. That works.

THE COURT: Okay.

MS. SESHENS: Thank you, Your Honor. Before we adjourn, I had promised Your Honor some cites on materiality. I just wanted to respond to Your Honor's prior question. And we cite two cases on Page 22 of our opposition on the Dr. James Motion in Limine. There are In re Merck and In re SLM Corp. Securities Litigation. And both are on the same page at the bottom of 22.

THE COURT: And that's under your opposition on?

MS. SESHENS: The Dr. James -- the challenge to Dr. James's materiality opinion as improper hindsight coming in. Your Honor had asked me previously for case s and I said I didn't have other s at the ready, but we pulled them together.

THE COURT: But you had also cited -- you had told me about Burlington on that topic and Gebhardt .

MS. SESHENS: I did. I just wanted to make sure Your Honor had plenty to read.

THE COURT: Thank you. Burlington and Gebhardt. Very good. We'll leave it there . Have a nice afternoon.

MS. SESHENS: Thank you very much, Your Honor.

THE COURT: Can I get some order s to conform with the rulings I have made thus far , please?

MR. YETTER: Yes, Your Honor.

MS. SESHENS: Absolutely.

MR. YETTER: We'll get those over to you.

THE COURT: If you-all can share it and have it all be one order thus far , I would appreciate that.

MR. YETTER: We'll do that, Judge.

THE STATE OF TEXAS)

COUNTY OF HARRIS)

I, Carolyn Ruiz Coronado, Official Court Reporter in and for the 151st Civil District Court of Harris County, State of Texas, do hereby certify that the above and foregoing contains a true and correct transcription of all portions of evidence and other proceedings requested in writing by counsel for the parties to be included in this volume of the Reporter's Record, in the above-styled and numbered cause, all of which occurred in open court or in chambers and were reported by me.

I further certify that this Reporter's Record of the proceedings truly and correctly reflects the exhibits, if any, admitted, tendered in an offer of proof or offered into evidence.

I further certify that the total cost for the preparation of this Reporter's Record is $1,243.00 and will be paid by Ms. Lauren Miller Etlinger, NORTON ROSE FULBRIGHT US LLP.

WITNESS MY OFFICIAL HAND this the 5th day of June, 2015.

/s/Carolyn Ruiz Coronado
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